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SUBJECT: U.S. Companies in South China are Profitable; Labor and Regulatory Challenges Remain

REFERENCE: A) Guangzhou 301; B) 06 Guangzhou 32385; C) 06 Guangzhou 31579; D) 06 Guangzhou 10089

(U) This document is sensitive but unclassified. Please protect accordingly.

11. (SBU) SUMMARY AND COMMENT: According to an AmCham-South China survey released on March 15, most U.S. investors in South China are profitable and planning further investments in 2007. Companies prefer Guangdong's Pearl River Delta (PRD) because of its large and relatively prosperous domestic market and its developed logistics network. The survey highlighted the gradual shift in the focus of U.S. companies in the past few years from manufacturing for export to manufacturing for the domestic market. Additionally, the number of companies providing services has increased to just over 50 percent. However, despite the rosy outlook, investors remain frustrated with regulators' lack of transparency, a dearth of skilled workers, and rising labor costs. A surprising 75 percent of survey participants have not made any preparations for an avian flu outbreak. Though business contacts often complain to Post of the difficulties of operating in South China's opaque and sometimes arbitrary business environment, this survey indicates that, on the whole, U.S. companies are doing well here, the domestic market is growing, and the market for services is increasing. END SUMMARY AND COMMENT.

About the Survey  
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12. (U) The 2007 State of Business in South China Survey, conducted by AmCham-South China and Hewitt Associates, surveyed 364 companies from January 14, 2007 to February 6, 2007. Half of the respondents are subsidiaries of U.S. companies and a majority has more than 10 years of experience in China. Three quarters are headquartered in either Guangzhou or Shenzhen. The respondents are split 50-50 between those that manufacture goods and those that provide services.

Profitability and Rising Investment  
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13. (U) According to the survey, most U.S. companies in South China are profitable and are meeting or exceeding budget expectations. Only those that established operations in China within the last two years are not profitable - though they almost all expect to see improvement within the next two years. The vast majority of companies expect to increase their China business activities and expand existing facilities during the next few years.

14. (U) Surveyed companies are also planning to increase their

investment levels throughout the country. In most cases the increase will be in the range of a few million dollars - a significant amount considering that most of the companies invested less than USD 10 million in China in 2006. A 2006 AmCham-South China survey found similar results in profitability and investment trends (ref C).

#### A Positive Business Climate

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¶5. (U) The vast majority of companies are satisfied with the business climate in South China, and most believe it has improved over the last 12 months. Almost all of the companies believe the government's economic reforms in 2006 were positive overall. As for why these companies chose Guangzhou or other South China cities as a base of operations, most cite the large and relatively prosperous customer base, proximity to Hong Kong, logistical and transportation advantages, and greater transparency.

#### Shifting to the Domestic Market and Services

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¶6. (U) Interestingly, the survey highlighted the gradual shift in the focus of U.S. companies during the past few years from a heavy emphasis on manufacturing for export to now manufacturing for the domestic market. This demonstrates the growing maturity and openness of the domestic market. Additionally, the number of companies providing services has increased to just over 50 percent, also reflecting greater market openness largely due to China's WTO accession.

#### Top Complaints: Regulatory Issues and Human Resources

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¶7. (U) Despite the generally positive impressions of China's reforms in 2006, companies still see regulatory issues as their biggest challenge in China. Though the survey does not cite specifics, business contacts have complained of a lack of transparency in local regulators' implementation of new laws. Human resource issues continue to be a serious concern for companies here as well, particularly the lack of qualified managerial and specialist talent, rising labor costs, and, to a lesser extent, a lack of unskilled labor (see reftel A). Companies see these challenges as unlikely to change over the next few years.

#### Avian Flu: Ignoring the Issue

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¶8. (SBU) Companies are no doubt aware of the risks of an avian flu outbreak in South China, both because of the intense media interest in 2006 and active outreach programs by AmCham and Post. However, three-quarters of companies still have not set up contingency plans, education campaigns, or vaccination programs for employees. Apparently, though companies are hearing the message, they are not taking it to heart.

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